



Comments on Performance Audit

Revised November 10, 2009

The purpose of performance audits is to objectively review an agency and all of its operations, policies and procedures in order to provide recommendations for improving the overall performance and efficiency of the agency.

Commerce management approached this audit in the spirit of cooperation and as an opportunity to identify ways to get better. The auditors looked at various aspects of Commerce evaluating a broad list of items. The report reflects only the areas in which the auditors offered formal recommendations for improvement.

Overall, Commerce managers agree with the vast majority of recommendations. Of the 50 formal recommendations, Commerce has implemented or is in the process of implementing 30 of them, and are either working on or giving due consideration to the rest. There are only three points with which Commerce disagreed and the objections are clearly listed in the audit report.

Audit Objectives and Scope

The two objectives of the audit, as described by the auditors are:

1. Does the application process and monitoring of the Centers of Excellence provide adequate accountability for the use of state funds?
2. Has an adequate system for monitoring operations of the Department of Commerce been established?

The report examined activities at Commerce between the timeframe of July 1, 2005 and Dec. 31, 2008.

A complete version of the report is available in PDF format from the State Auditor's office:
State Auditor's Performance Audit – North Dakota Department of Commerce – Report No. 3027

Audit Recommendations

Most of the recommendations fall into four areas:

1. Recommendations pertaining to items Commerce had also identified or were in the process of developing.
 - For example, the auditors recommended Commerce periodically review applicable Century Code sections and ensure compliance with requirements or take action to change the law. We actually do this prior to each legislative session. In the last session, for example, we made a number of changes in both ED&F and Tourism, including eliminating the Motion Picture Development Office, so the Century Code more accurately reflects our mission and work.
2. Recommendations pertaining to internal policy or procedural changes. A large number of these recommendations address very specific policies and procedures at Commerce on issues such as cell phone policies, records management, using secured websites, improving or in some cases formalizing the way we document activities, and making sure all of our program board members sign a code of ethics.



3. Recommendations for formalizing procedures in writing. In many cases this means taking current practice and developing a written policy that reflects the practice. Six of the 15 recommendations for the Centers of Excellence program are of that nature.

4. Recommendations for improving the Centers of Excellence monitoring program. This is an area where Commerce welcomed the experienced eyes of the auditors. After the 2007 Legislative session, Commerce officially received the authority to build a monitoring function with direct access to the data and information generated by each Center. So for much of the timeframe of this audit the Department of Commerce was either not charged with monitoring the Centers (2005-2007 biennium) or was in the beginning stages of building these monitoring procedures (July 1, 2007, through December 2008).

Commissioner Goettle cooperated with the auditors and personally worked with the Centers of Excellence Commission to adjust some of the monitoring procedures for the Centers of Excellence program.

Employee Survey

The audit also included a survey of employees to determine the work environment and staff morale at the agency. This was a real bright spot in the audit. Auditors noted that 87 percent of Commerce employees said senior managers communicate well with employees and 72 percent said they can disagree with management without fear of consequences. Creating good morale and a positive working environment at Commerce has been a priority for managers and the comments of staff in this audit survey reflect success in this area.

Audit Recommendations

Section One: Centers of Excellence

1. Determining Economic Impact of Centers of Excellence

We recommend the Centers of Excellence Commission ensure compliance with North Dakota Century Code Section 15-69-04, Subsection 5 and determine whether Centers of Excellence are having the desired economic impact.

Commerce Comments

Commerce and the Centers of Excellence Commission agree with this recommendation and conducted an **economic impact study of the Centers** in 2007. The mathematical error contained in the economic impact report referenced by the audit was an error in the totaling of direct and indirect jobs. Commerce checked with Dr. Larry Leistritz who conducted the economic impact study and the math error did not affect the overall economic impact figures of the study nor do the audit findings refute the credibility of the economic impact study as a whole. Dr. Leistritz is widely regarded and trusted economic researcher and has performed similar economic impact studies on research activities in the state including for the Red River Valley Research Corridor. In the future, Commerce will make site visits to verify all the information reported by campuses in their functional reviews. However, Commerce and the Centers of Excellence Commission have no reason to think the information campuses provided in past functional reviews is invalid and trust the campuses are acting in good faith and in accordance with state law in terms of the figures they are reporting. Commerce will also do an economic assessment of each Center as recommended by the auditors.

2. Complying with State Law

We recommend the Department of Commerce ensure applications provided to the Centers of

Excellence Commission contain budgeted expenditures which are in compliance with state law.

Commerce Comments

Reviewing applications for Centers of Excellence to ensure they are in compliance with state law has always been part of the application process. The approval process is extensive and requires the review and approval of the six-member Centers of Excellence Commission, the North Dakota Economic Development Foundation, State Board of Higher Education, the Emergency Commission and the full Budget Section of the state Legislature. Commerce agrees with this audit recommendation and will ensure that this review occurs *prior to* consideration by the Centers of Excellence Commission, which is the first body in the approval process.

3. Formalizing Policies for the Application Process

We recommend the Centers of Excellence Commission establish formal policies and procedures for the application process. At a minimum, the policies should address:

- a) Definitions of key terms used in the application;
- b) Submission of revised applications, budgets, and/or other information when recommending a lesser amount than is being requested;
- c) Submission of information from Centers of Excellence previously receiving funding; and
- d) Completed applications being forwarded to the Commission.

Commerce Comments

The Centers of Excellence Commission has now formalized in writing the policies and procedures for the application process which address the identified items. The Commission has followed a set of policies and procedures for its various functions; they simply were not formalized in writing.

4. Formalizing Policies for Evaluating Applications

We recommend the Centers of Excellence Commission establish formal policies and procedures for the evaluation of applications. At a minimum, the policies should address:

- a) A process incorporating all elements in North Dakota Century Code for consideration in approving and disapproving applications; and
- b) Additional elements of consideration on applications from Centers of Excellence which were previously approved.

Commerce Comments

The Centers of Excellence Commission has now formalized in writing the policies and procedures for the evaluation of applications.

The Centers of Excellence Commission has considered all applicable elements spelled out in the law during the evaluation of applications, the process simply was not formalized in writing. In fact, the application format utilized by the Commission is based directly on the criteria listed in law. By formalizing in writing these policies and procedures, the Commission will now have the documentation for the evaluation process that the auditors have recommended.

5. Establishing Criteria to Determine Funding Levels and to Analyze Effects of Changes

We recommend the Centers of Excellence Commission establish criteria to be used for determining the approved funding amount in applications and analyze the effects of changing requested funding amounts of projects.

Commerce Comments

Commerce agrees with this recommendation and the Centers of Excellence Commission has

now formalized in writing the criteria and process for determining the appropriate funding level for a Center and has formalized the process used to determine the effects of changing the requested funding amounts.

In the past applicants have been asked to provide information describing the impact that specific reductions in funding would have on their respective projects. After assessing all of the information, the Commission would determine the level of funding to be awarded. In the event that a proposal was not fully funded, the applicant was required to submit a revised application which reflected the impact to areas including the scope of work and budget.

6. Establish Formal Policies Regarding Technical Reviews

We recommend the Centers of Excellence Commission establish formal policies and procedures for technical reviews of applications. At a minimum, the policies should address:

- a) A process for identifying proposals requiring a review;
- b) Selection of a vendor to perform the review; and
- c) Ensuring sufficient time exists to allow a review to be performed.

Commerce Comments

The Centers of Excellence Commission had an established process for determining whether an application requires technical review. Each Commission member has the ability to call to attention any proposal that may necessitate a technical review. In the event the Commission desired a technical review, Commerce would facilitate the contracting of an appropriate entity to perform the review. In such situations Commerce is to follow appropriate procurement procedures. This process is now captured in writing as a formal procedure.

7. Timing of Due Diligence Process

We recommend the Centers of Excellence Commission review the due diligence requirements and either:

- a) Move the due diligence work to the beginning of the application process; or
- b) Ensure an adequate amount of time is provided to allow the Department of Commerce to complete the due diligence work.

Commerce Comments

Due to the established timeframes of the Centers of Excellence application process in the past, the due diligence work was required to be completed in a narrow window. Commerce agrees with this recommendation and the Centers of Excellence Commission has now revised the timelines and moved the due diligence work to the beginning of the application process.

8. Entering Formal Agreements

We recommend the Centers of Excellence Commission enter into formal agreements with approved applicants. At a minimum, the agreements should address:

- a) Criteria for the use of state funds;
- b) Documentation requirements for payroll expenses; and
- c) Compliance with applicable purchasing policies.

Commerce Comments

The Centers have always been required to sign formal contracts called "Compliance Agreements." These were developed with the Attorney General's Office. However, the audit recommends that the agreements be signed by both parties (the Centers and the Commission) and include some additional provisions. Commerce will implement this change immediately.

9. Updating the Functional Reviews

We recommend the Centers of Excellence Commission update the functional review to improve the efficiency and effectiveness of the monitoring and reporting process.

Commerce Comments

On June 3, 2009 the Centers of Excellence Commission authorized the Department of Commerce to update the functional review format. Existing segments of the review were revised so information would be reported in a more clear and concise manner. New segments were incorporated that will help assess each Center's progress towards the assertions made in their respective applications. Finally, segments of the report that did not yield useful information from a monitoring stand point were eliminated. The functional review format has been updated and the Centers of Excellence Commission, along with the Department of Commerce, will continue to search for ways to improve it.

10. Establishing Formal Policies for Monitoring the Centers We recommend the Centers of Excellence Commission establish formal policies and procedures for monitoring the Centers of Excellence. At a minimum, the policies should address:

- a) Establishing quarterly monitoring requirements;
- b) Assessing job creation activities;
- c) Assessing significant variations from the applications;
- d) Establishing different reviews after the match has been met or after a specified period of time has expired;
- e) Establishing the frequency of updates to the Commission and/or holding meetings specifically for monitoring.

Commerce Comments

Commerce first gained authority to establish a monitoring process for the Centers of Excellence Program in July, 2007. Since then, Commerce has worked to develop this process which included hiring an accountability officer in 2008, improving a functional review process and collecting reviews from each Center that measured job creation, quantified private sector match and measured progress toward the Center's overall stated goals.

Many of the monitoring policies and procedures had not been formalized in writing. By formalizing in writing these policies and procedures, the Centers of Excellence Commission will now have the documentation for the monitoring process that the auditors recommend.

11. Monitoring Compliance with North Dakota Century Code

We recommend the Centers of Excellence Commission monitor compliance with North Dakota Century Code Section 15-69-05, Subsection 2 and ensure annual audits are completed or take appropriate action to modify the requirement for annual audits of Centers of Excellence.

Commerce Comments

The auditors determined that the current Agreed Upon Procedures audit that has been used to fulfill the annual audit requirement did not constitute an audit because the parties performing the work simply stated their findings and did not express an opinion. The Centers of Excellence Commission intends to request that the legislature clarify whether a full fiscal audit is required. The Commission is currently considering its options on how best to proceed with the annual audit requirement prior to the next legislative session.

12. Establishing Measurable Annual Goals

We recommend the Centers of Excellence Commission require the Centers of Excellence to establish measurable goals and objectives at least annually.

Commerce Comments

The Centers have been reported based on their progress toward meeting the goals established in their original application. In accordance with this recommendation, the Centers of Excellence Commission will request that each new applicant establish measurable goals and objectives on an annual basis, and not just in the application. The awarded centers will be evaluated against their original application.

13. Establishing Policies Regarding Non-Compliance or Failure to Meet Expectations

We recommend the Centers of Excellence Commission establish formal policies and procedures addressing actions to be taken when Centers of Excellence are in noncompliance with requirements and when Centers of Excellence are not meeting stated expectations.

Commerce Comments

The Centers of Excellence Commission agrees with this recommendation and will establish written policies and procedures addressing action to be taken when Centers are not in compliance with requirements or are not meeting stated expectations. These policies and procedures may include provisions being inserted into the formal award agreements with the Centers on what the actions will be. Any potential actions will be within the authority granted to the Commission in state law. It is also important to note that, by law, each Center is to be evaluated on a six to ten year time-frame. National economic conditions have impacted some private sector partners. This may require adjustments to and patience with expectations, but does not detract from the long-term potential of the project. While match dollars may still be needed on some approved projects, the 2:1 match is being met on all projects before any awarded dollars are spent by the recipient.

14. Establishing Formal Policies for Matching Requirements

We recommend the Centers of Excellence Commission establish formal policies and procedures related to matching requirements. At a minimum, the policies should address:

- a) Required documentation to receive Centers of Excellence funds after an application is approved; and
- b) Requirements for verifying match and leverage amounts are actually received.

Commerce Comments

The Centers of Excellence Commission will formalize in writing the policies and procedures related to matching requirements. The auditors found some instances when Centers failed to provide supporting documentation for contributions claimed as part of the functional review process, however, in one instance the documentation had been previously provided in the application process. In another instance the auditors noted a contribution of \$383,000 worth of in-kind equipment was not documented. It is important to note that this \$383,000 constituted leverage over-and-above the required 2:1 match, not the match itself. The auditors also suggested we consider whether the documentation currently required in order to receive COE funds after an application is approved is sufficient.

15. Establishing an Orientation Program for Commission Members

We recommend the Centers of Excellence Commission establish a formal orientation training process for its members. At a minimum, the process should include:

- a) Identifying all state law requirements of the Commission; and
- b) Ensuring compliance with Code of Ethics requirements.

Commerce Comments

Commerce has already implemented this recommendation and a formal orientation and training process is in place. The most recently appointed Centers of Excellence Commission member has been through this process and the existing members have received the orientation materials. Each current member of the Centers of Excellence Commission has signed an acknowledgement agreeing to the Code of Ethics requirements.

Sections Two, Three and Four: Monitoring Operations of the Commerce Department, the Development Fund and Ag Products Utilization Commission

The Performance Audit includes 35 recommendations for improving operations in the Department of Commerce, the North Dakota Development Fund, and the Ag Products Utilization Commission. A majority of these recommendations are fairly routine. The following recommendations have raised questions by legislators or others and require additional context.

Recommendation 2-14

We recommend the Department of Commerce make improvements with procurement processes to ensure compliance with laws and policies.

Commerce Comments Auditors examined 63 different procurement expenditures and found seven areas of non-compliance:

1. C&H Glass – Initially, one set of plexi-glass was purchased on a trial basis for the Tourism rest area brochure rack program. It was determined that it worked well and enough glass was then purchased for all the rest areas. Commerce did not anticipate the expenditure to be over \$2,500 when we made the first purchase. Total purchase ended up being \$3,652. Three quotes were not received.
2. Smith Travel Research – This has been a sole source vendor since October 2004. We did not fill out the appropriate form. We will do a sole source form the next time this contract is renewed.
3. ASAP Software – Commerce purchased software from the vendor that we had made our last software purchase from without verifying whether or not they still had the state contract. It turned out that for this time frame they did not have the state contract and therefore we should not have purchased from them. They did have the state contract previously and again are the current vendor.
4. Photography – Commerce believed that photography was a promotional expense and did not fall under the procurement guidelines.

5. HR Resources – Three vendors were solicited to provide bids. One responded with a bid, one responded and said they only work with entities that employ 500 or more, and the third was a no response. We determined according Administrative Code 4-12-12-11-08 Choice A that the specifications were not restrictive, the other vendors had opportunity to respond, and the price we received from the one vendor was reasonable.

6. Inet Technologies – This is a vendor that is listed within State Contract 095. Agencies may purchase directly from this vendor by filling out work order requests. In this instance we neglected to fill out the work order request.

7. Photography – Same as above

Recommendation 2-16

We recommend the Department of Commerce comply with legislative intent for use of line item appropriations and full-time equivalent positions.

Commerce Comments

Commerce believes it has complied with legislative intent for line item appropriations and full time equivalent positions and will continue to do so. Context regarding the problems identified by the auditors is included below:

Lewis and Clark marketing: Auditors found four instances where funds specified *directly* for Lewis and Clark marketing were used for projects *indirectly* relating to Lewis and Clark. Examples of the cooperative nature of tourism marketing were provided to the Legislature during testimony in 2003 when the initial marketing program was proposed. Experiences along the Lewis and Clark Trail were used as the primary lure to attract visitors during the bicentennial years. But due to the nature of tourism marketing, other activities, attractions and events were marketed cooperatively and resources leveraged so as to offer a complete package to visitors who in many cases travel many miles to get to North Dakota. For example, a photographer was hired to work both on and off the Trail capturing images that were used in various publications as well as on the web site. Although this invoice was not prorated, there were also many other bills that included Lewis & Clark promotions that were not billed to that line item. Examples of these include Group Travel Guides, international pieces and the official State Travel Guide issues 2003-2009. Each of the Travel Guides devoted several pages (up to eight) to Lewis & Clark. The cost to produce, print and mail this piece was not prorated to the Lewis & Clark line. As shown in newsletters, annual reports and legislative testimony the transition from Lewis & Clark to a broader statewide culture and heritage program was transparent and the strategy was supported by tourism industry stakeholders and lawmakers alike.

American Indian Business Development Office: Commerce also believes it complied with legislative intent concerning the American Indian Business Development Office. Commerce evaluated the needs of this program and worked closely with legislators involved in creating the American Indian Business Development Office to best meet these needs. Ultimately, Commerce determined that the best services could be provided through a vendor. This action was communicated to and affirmed by the 2007 legislative session.

Commerce has broad legislative authority and intent to internally allocate staff positions and to contract for services with outside vendors. The legislative designation that makes all officers and employees of the agency “non-classified” is one example. Commerce management must make judgments about how best to utilize limited resources, both human and financial, in order

to effectively deliver public programs and services assigned to it by the legislature. This includes contracting out functions and deploying full-time equivalent positions in the most efficient and effective way possible. Commerce has broad authority to organize and reorganize its full-time equivalent positions, and any added FTE positions must be considered within the context of this preexisting statutory authority. Commerce also has both implicit authority and explicit authority to contract out functions it deems are best handled by vendors instead of full-time equivalent positions.

Recommendation 2-17

We recommend the Department of Commerce ensure employees are paid overtime and earn compensatory time only when hours actually worked exceed 40 in a week.

Commerce Comments

This stems from a policy that generally only affects eight of Commerce's 68 employees (unless preauthorized for other positions) for a total cost of \$3,008 for this time period. These eight employees are eligible for comp-time accrual in the agency. The situation arises only when an employee who is eligible for comp-time is sick or takes leave during a week in which the employee is also asked to work additional hours on separate days or weekends. The auditors referred us to OMB's internal policy and practice, which treats the additional hours as flex time instead of paid overtime or comp-time. This requires the employee to instead amend leave slips such that leave is reduced or eliminated for the week in question.

This recommendation is intended to ensure more uniform treatment of comp-time and overtime throughout state government. We agree with Recommendation 2-17 and immediately implemented it after it was brought to our attention. Commerce has also opened discussions with OMB and other state agencies about the rationale behind similar internal policies and practices, and their fairness to employees.

Recommendation 2-19 We recommend the Department of Commerce make changes to their cell phone policy. At a minimum, the policy should:

- a) Be consistent with Office of Management and Budget policy; and
- b) Address the use of state issued cell phones for personal use.

Commerce Comments This policy affected seven employees who were reimbursed for minutes used under their personal plan that were "technically" free. Commerce initially adopted the cell phone policy flagged by the auditors in order to compensate employees due to the fact that many were purchasing more expensive plans in order to have more minutes available for business use. Ultimately, Commerce determined this was less expensive than the other possible alternatives which are to purchase cell phones for employee use or calling cards for employees to use for business purposes. Since the old policy is cumbersome and few employees made any claims for reimbursement under the policy, Commerce has already amended the cell phone policy in line with the audit recommendation.